



**CITY OF HAYWARD**  
**AGENDA REPORT**

AGENDA DATE 03/01/05  
AGENDA ITEM \_\_\_\_\_  
WORK SESSION ITEM WS #2(1)

**TO:** Mayor and City Council  
**FROM:** Acting Director of Finance and Internal Services  
**SUBJECT:** 2003-04 Management Letter and Comprehensive Annual Financial Report

**RECOMMENDATION:**

It is recommended that the City Council review and comment on this report.

**BACKGROUND:**

The City's auditors have completed their audit of the City's financial records for the year ended June 30, 2004. Copies of the audited financial statements have been transmitted to Council under separate cover. In addition to the audited statements, the auditors have completed and provided to the City their management letter for 2003-04.

There are two major objectives of the management letter. The first is to advise the Council of any material weaknesses in the City's systems of internal financial controls. The second is to communicate to the Council any opportunities for improved controls or efficiencies that the auditors may have noted during the course of their audit. A copy of the auditor's management letter is attached for Council's review. The following section contains staff's response to the auditor's management letter for 2003-04.

**Management Letter Response**

First, staff is pleased to report that the auditors report no instances of a material weakness in the City's system of financial controls. The auditors have made other recommendations, however, which they believe would be of benefit to the City, if implemented. Staff's response, which follows, summarizes and discusses each of the Auditors recommendations. The recommendations are addressed in the same sequence as contained in the management letter.

**New Accounting Standards for Other Post Employment Benefits (OPEB)**

The auditors recommend that the City begin to prepare for the recording of future obligations for post employment benefits, such as healthcare, in its financial statements beginning in 2007-08.

Staff agrees with this recommendation and will begin a process to prepare for this new reporting requirement.

### **New Cash and Investment Disclosures for Next Year**

The auditors note new accounting disclosures effective next year on the presentation of investments and their related risks in the City's financial statements. Staff recognizes the new requirements and will make provisions to incorporate the new accounting disclosures in its financial statements for the next fiscal year.

### **Payroll**

For the purposes of checks and balances, the auditors recommend the City's payroll Senior Account Clerk in the Accounting Division not have access to computer screens associated with setting up new employees. Instead, the auditors suggest that access to these screens rest with the Human Resources Department. Staff agrees with this recommendation and over the course of the audit, implemented this recommendation.

### **Debt Proceeds Accounts**

The auditors recommend that as a good cash management practice, the City should review its Trustee accounts, created as a result of a debt issue, that have remaining balances and determine whether they should be closed or not. Staff agrees with this recommendation and has implemented a plan to periodically review and determine the status of each account. Of the eight issues mentioned in the management letter, five accounts have been identified to be closed while the remaining three accounts are committed for continuing projects.

The auditors also noted that the value of collateral pledged for an investment contract was below the investment contract balance and noted the City should make arrangements for additional collateral. Staff understands this recommendation and will review the collateral value periodically. The reason for the difference is timing-related during a declining market for fixed interest investment contracts. The City plans to hold this investment contract to maturity, at which point the value of the pledged collateral will be more than sufficient to cover the balance.

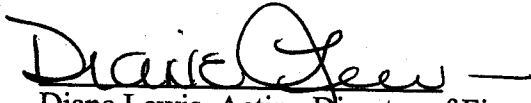
### **Comprehensive Annual Financial Report**

As noted above, Council has been provided with the City's audited financial statements for the year ended June 30, 2004 consisting of audits for the Enterprise Funds, the Redevelopment Agency and others, as well as the City's Comprehensive Annual Financial Report or CAFR. This report includes all funds of the City including the General Fund. As Council is aware, the General Fund accounts for such major public service areas as public safety, public works, community and economic development and administration.


Staff is proud to report that the auditor's opinion on the financial statements for 2003-04 is without exception. That is, the auditor's report is not restricted (qualified) in some manner nor does it take exception to any of the information contained in the City's financial statements.

While a qualification or exception is not necessarily detrimental, staff is happy to report that the City's financial statements continue to earn a "clean opinion".

Recommended by:

  
Diane Lewis, Acting Director of Finance and Internal Services

Approved by:

  
Jesús Armas, City Manager

Attachments

**CITY OF HAYWARD  
MEMORANDUM ON  
INTERNAL CONTROL STRUCTURE  
FOR THE YEAR ENDED JUNE 30, 2004**

# MAZE & ASSOCIATES

---

November 19, 2004

To the City Council of  
the City of Hayward, California

**ACCOUNTANCY CORPORATION**  
1931 San Miguel Drive - Suite 100  
Walnut Creek, California 94596  
(925) 930-0902 • FAX (925) 930-0135  
E-Mail: [maze@mazeassociates.com](mailto:maze@mazeassociates.com)  
Website: [www.mazeassociates.com](http://www.mazeassociates.com)

Under generally accepted auditing standards, auditors are encouraged to report various matters concerning an entity's internal control structure noted during an audit, and are required to report certain of those matters. Matters that are required to be reported are significant deficiencies in the design or the operation of the internal control structure that, in the auditor's judgment, could adversely affect the organization's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

As part of our audit of the financial statements of the City of Hayward for the year ended June 30, 2004, we considered the City's internal control structure in determining the scope of our audit procedures for the purpose of rendering an opinion on the financial statements. While our purpose was not to provide assurances on the internal control structure, certain matters came to our attention that we want to report to you. These matters, along with our recommendations, are described in the accompanying memorandum.

A material weakness is a significant deficiency in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses as defined above. However, none of the matters described in the accompanying memorandum is believed to be a material weakness.

The accompanying memorandum on internal control structure is intended solely for the use of management and the City Council. This restriction is not intended to limit the distribution of this letter and the accompanying memorandum which, upon acceptance by the City Council, are a matter of public record. To the extent that the City Council intends to rely upon this letter and the accompanying memorandum, such reliance should take into account the limited basis on which our recommendations were developed, as described above, and the limitations inherent in the internal control structure. In addition, the City Council should understand that the criteria used by us in considering the internal control structure could differ significantly from the criteria the City Council may be using for its purpose.

We wish to express our appreciation for the courtesies and cooperation extended to our representatives during the course of their work. We would be pleased to discuss these recommendations in greater detail or otherwise assist in their implementation.

Very truly yours,

*Maze Associates*

**CITY OF HAYWARD**  
**MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

**New Accounting Standards for Other Post Employment Benefits (OPEB)**

Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, addresses how state and local governments account for and report postemployment healthcare and other nonpension benefits. The statement generally requires that state and local governmental employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions.

These new rules take effect in fiscal 2007-08 for the City, and require the determination of an actuarial accrued liability (future obligation) to pay for OPEB. An actuarially based funding plan will need to be determined to ensure the City accumulates funds to pay for these obligations. So long as the City sets aside funds using this basis, there will be no impact on the City's financial statements.

**New Cash and Investment Disclosures for Next Year**

The Governmental Accounting Standards Board has issued Statement #40, *Deposit and Investment Risk Disclosures - an amendment of GASB Statement No. 3*, which is effective for fiscal 2004-2005. These new rules change cash and investment disclosures for municipalities and require the presentation of new data. Although the rules do not take effect until next year, we have included a summary here for your use in the coming year to ensure needed data will be ready. A summary of changes are presented below:

- *Cash in Financial Institutions* - Under the current rules, the City's cash is required to be allocated and disclosed under 3 categories differentiating the degree of custodial risk. Under the new rules, only those cash balances falling into the highest degree of custodial risk (uninsured and uncategorized cash) need to be disclosed. These reduced disclosures will not require a change in what has been assembled in past years.
- *Investment Custodial Risk* - Under the current rules, the City's investments are required to be allocated and disclosed under 3 categories differentiating the degree of custodial risk. Under the new rules, only those investments falling into the highest degree of custodial risk (uninsured and unregistered cash) need to be disclosed.
- *Concentrations of Credit Risks* - The City will need to assemble information about the concentration of credit risks associated with its investments. For investments in any one issuer that represent 5 percent or more of total investments the City is required to disclose the aggregate amount and issuer name. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement.

**CITY OF HAYWARD**  
**MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

- *Component Unit and Fund Level Concentrations* - The disclosures should be made for the City, including its blended component units. Risk disclosures should also be made for governmental and business-type activities, individual major funds, nonmajor funds in the aggregate, or fiduciary fund types when the risk exposures are significantly greater than the deposit and investment risks of the City. For example, a City's total investments may not be exposed to concentration risk. However, if the City's capital projects fund has all of its investments in one issuer of corporate bonds, disclosure should be made for the capital projects fund's exposure to a concentration of credit risk.
- *Credit Risk Quality* - The City will need to disclose the credit quality ratings of investments in debt securities as of year-end. Investments of the same type and rating may be aggregated for this purpose. Unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. Governments should disclose the credit quality ratings of external investment pools, money market funds, bond mutual funds, and other pooled investments of fixed-income securities in which they invest. If a credit quality disclosure is required and the investment is unrated, the disclosure should indicate that fact.
- *Interest Rate Risk*- The City will need to disclose information about the interest rate risk of their debt investments by using one of several a disclosure methods. The City will also need to disclose the terms of investments with fair values that are highly sensitive to changes in interest rates. The City is encouraged to use the method that is consistent with the method it uses to manage interest rate risk. Methods suggested include segmented time distributions, the specific identification method, weighted average maturity, duration and simulation models.

Governments with investments in mutual funds, external investment pools, or other pooled investments that do not meet the definition of a 2a7-like pool should disclose interest rate risk information according to one of the methods above.

- *Policy Disclosures* - If a government has an exposure to a concentration of credit risk, an investment policy disclosure regarding concentration of credit risk is required, or if a government has an investment denominated in a foreign currency, an investment policy disclosure regarding foreign investments is required. If a government has no deposit or investment policy that addresses a specific type of risk that it is exposed to, the disclosure should indicate that fact.
- *Investments Sensitive to Interest Rate Change* - GASB #40 requires certain disclosures for investment fair values that are highly sensitive to changes in interest rates. Although seemingly a simple issue, this can be in fact difficult to determine as some investments have hidden derivative features. The City will need to closely examine it investments with fiscal agents to determine if any investments fit the above requirements and require disclosure.
- *Foreign Currency Risk* - A City's deposits or investments exposed to foreign currency risk should disclose the U.S. dollar balances of such deposits or investments, organized by currency denomination and, if applicable, investment type.

**CITY OF HAYWARD**  
**MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

**Payroll**

Computer Access - The payroll Senior Account Clerk has access to modules that should be segregated to Human Resources, such as the modules used to set up new employees. We recommend the City review the computer access report for payroll and properly segregate modules for payroll processing used by the payroll Senior Account Clerk from the modules to set up new employees used by the Human Resources Department.

**Debt Proceeds Accounts**

The City has been active in the debt market and has issued a variety of leases, certificates of participation of other forms of debt. As of June 30, 2004, there were eight issues at least one year or older that had project or cost of issues accounts with remaining balances. As a good cash management practice, the City should review the issues, confirm that no additional charges will be assessed against the funds and then close the Trustee accounts in compliance with the debt agreement.

In addition, as of June 30, 2004 a Trustee held \$894,066 in an investment contract for the 1996 Sewer Revenue Bonds Reserve Fund. The investment contract is secured by a pledge of collateral. However the value of the collateral was less than the investment contract balance and amounted to \$865,062 on June 30, 2004. The City should contact the Trustee and arrange for additional collateral.



**CITY OF HAYWARD**  
**MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

- *Component Unit and Fund Level Concentrations* - The disclosures should be made for the City, including its blended component units. Risk disclosures should also be made for governmental and business-type activities, individual major funds, nonmajor funds in the aggregate, or fiduciary fund types when the risk exposures are significantly greater than the deposit and investment risks of the City. For example, a City's total investments may not be exposed to concentration risk. However, if the City's capital projects fund has all of its investments in one issuer of corporate bonds, disclosure should be made for the capital projects fund's exposure to a concentration of credit risk.
- *Credit Risk Quality* - The City will need to disclose the credit quality ratings of investments in debt securities as of year-end. Investments of the same type and rating may be aggregated for this purpose. Unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. Governments should disclose the credit quality ratings of external investment pools, money market funds, bond mutual funds, and other pooled investments of fixed-income securities in which they invest. If a credit quality disclosure is required and the investment is unrated, the disclosure should indicate that fact.
- *Interest Rate Risk*- The City will need to disclose information about the interest rate risk of their debt investments by using one of several a disclosure methods. The City will also need to disclose the terms of investments with fair values that are highly sensitive to changes in interest rates. The City is encouraged to use the method that is consistent with the method it uses to manage interest rate risk. Methods suggested include segmented time distributions, the specific identification method, weighted average maturity, duration and simulation models.

Governments with investments in mutual funds, external investment pools, or other pooled investments that do not meet the definition of a 2a7-like pool should disclose interest rate risk information according to one of the methods above.

- *Policy Disclosures* - If a government has an exposure to a concentration of credit risk, an investment policy disclosure regarding concentration of credit risk is required, or if a government has an investment denominated in a foreign currency, an investment policy disclosure regarding foreign investments is required. If a government has no deposit or investment policy that addresses a specific type of risk that it is exposed to, the disclosure should indicate that fact.
- *Investments Sensitive to Interest Rate Change* - GASB #40 requires certain disclosures for investment fair values that are highly sensitive to changes in interest rates. Although seemingly a simple issue, this can be in fact difficult to determine as some investments have hidden derivative features. The City will need to closely examine it investments with fiscal agents to determine if any investments fit the above requirements and require disclosure.
- *Foreign Currency Risk* - A City's deposits or investments exposed to foreign currency risk should disclose the U.S. dollar balances of such deposits or investments, organized by currency denomination and, if applicable, investment type.

**CITY OF HAYWARD**  
**MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

**Payroll**

Computer Access - The payroll Senior Account Clerk has access to modules that should be segregated to Human Resources, such as the modules used to set up new employees. We recommend the City review the computer access report for payroll and properly segregate modules for payroll processing used by the payroll Senior Account Clerk from the modules to set up new employees used by the Human Resources Department.

**Debt Proceeds Accounts**

The City has been active in the debt market and has issued a variety of leases, certificates of participation of other forms of debt. As of June 30, 2004, there were eight issues at least one year or older that had project or cost of issues accounts with remaining balances. As a good cash management practice, the City should review the issues, confirm that no additional charges will be assessed against the funds and then close the Trustee accounts in compliance with the debt agreement.

In addition, as of June 30, 2004 a Trustee held \$894,066 in an investment contract for the 1996 Sewer Revenue Bonds Reserve Fund. The investment contract is secured by a pledge of collateral. However the value of the collateral was less than the investment contract balance and amounted to \$865,062 on June 30, 2004. The City should contact the Trustee and arrange for additional collateral.